



100 Years Standing Up for American Enterprise
U.S. CHAMBER OF COMMERCE

Statement of the U.S. Chamber of Commerce

ON: Joint Hearing on Tax Reform and the Tax Treatment of
Capital Gains

TO: Senate Finance Committee and House Committee on Ways
and Means

DATE: September 20, 2012

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,
incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance -- is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 115 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The Chamber thanks Chairmen Camp and Baucus, and Ranking Members Levin and Hatch, for the opportunity to comment on the tax treatment of capital gains in the context of comprehensive tax reform.

The Chamber commends the Committees for their considerable efforts in pursuing the daunting task of fundamental tax reform. We particularly appreciate the number and scope of the public hearings the Committees have held on many of the difficult and important issues that must be addressed in tax reform.

The Chamber applauds your continuing work toward comprehensive reform but believes that true fundamental tax reform is still a long way down the road. Thus, the Chamber urges the Committees and Congress to act immediately to extend all expiring 2001 and 2003 tax rates, including the current capital gains tax rate, along with all other expired and expiring tax provisions, to prevent the negative impact on jobs and the fragile economy that is likely to result from inaction.

THE NEED FOR IMMEDIATE ACTION

As noted in the Advisory for this hearing, unless Congress acts, the maximum statutory capital gains rate will automatically increase from 15 percent to 20 percent on January 1, 2013. The “Pease” limitation on itemized deductions also automatically occurs at the beginning of 2013, which will raise the top capital gains rate an additional 1.2 percent. Further, in 2013, capital gains will be subject to the Medicare HI tax, adding another 3.8 percent tax to the capital gains tax rate. In short, absent Congressional action, the top federal capital gains tax rate will increase to 25 percent in 2013.

Further, many other tax increases, as well as spending cuts, will automatically occur on January 1, 2013 unless Congress acts to extend them. The Congressional Budget Office (“CBO”) estimates that failure to address these expired and expiring provisions, including the current capital gains tax rate, combined with looming spending cuts will result in an estimated \$500 billion fiscal policy reduction in 2013.¹

The negative impact of Congress’s inaction on the weak economy could be devastating. According to CBO, if Congress fails to act, growth is expected to slow from 2.2 percent in the fourth quarter of 2012 to -.5 percent in the fourth quarter of 2013 and to remain below its potential rate until 2018.² Slower projected growth would result in a weaker labor market and a higher unemployment rate. CBO projects that the unemployment rate would increase from 8.2 percent in 2012 to 9.1 percent in 2013, which means that an additional 1.3 million people will become unemployed in 2013 if Congress fails to act. According to CBO, “in light of the way it has identified past recessions, the National Bureau of Economic Research would probably view

¹ See http://www.cbo.gov/sites/default/files/cbofiles/attachments/08-22-2012-Update_to_Outlook.pdf

² See id.

such a contraction in output in the first half of 2013 as a recession (similar in magnitude to the recession in the early 1990s).”³

Similarly, Mark Zandi, from Moody’s Analytics, estimates that without changes to fiscal policy, the fiscal drag will subtract more than 3.0 percentage points from GDP in 2013 while former Federal Reserve Vice Chairman Alan Blinder believes the “resulting fiscal contraction – consisting of both tax increases and spending cuts – would be about 3.5 percent of gross domestic product” and would be a “disaster for the United States.”

The Chamber believes that Congress needs to act immediately to prevent the negative impact on jobs and the fragile economy that is likely to result from failure to extend the current capital gains tax rate and the other expired and expiring tax provisions. We believe that the best way to get the economy growing fast enough to create jobs and drive the unemployment rate down is to ensure that taxes do not increase for consumers and businesses.

The Chamber appreciates that all tax policies, including the taxation of capital gains, must be carefully examined in the context of fundamental tax reform. However, we must not delay extending the current capital gains rates and other expired and expiring provisions while we engage in that debate.

CAPITAL GAINS AND COMPREHENSIVE TAX REFORM

As the Committees and Congress consider comprehensive tax reform, the Chamber believes that taxes on capital gains should be as low as possible. Capital gains represent the rewards for placing capital at risk and, accordingly, are a critical element in capital formation. Higher capital gains taxes inhibit capital formation and mobility. Further, capital gains often consist of illusory profits created by inflation, taxation of which erodes our capital base. Low capital gains rates increase federal revenues because of the negative effect high rates have on the rate at which gains are realized.

The impact of taxing capital gains is vast.

According to the IRS SOI,⁴ in 2009, 5 million tax returns reported \$240 billion of long-term capital gains. Taxpayers with adjusted gross income (AGI) of less than \$100,000 accounted for 62 percent of those returns, while taxpayers with AGI of less than \$50,000 accounted for 35 percent of those returns.⁵

According to the Tax Foundation (in reliance on IRS SOI data),⁶ older Americans and those saving for retirement would be disproportionately hurt by a tax increase on capital gains income. Older Americans rely on income from capital gains. For 2009, among taxpayers with

³ See *id.*

⁴ See IRS Statistics of Income (SOI), Individual Income Tax Returns, 2009, available at <http://www.irs.gov/pub/irs-soi/11infallbulincome.pdf>.

⁵ See *id.*

⁶ See Tax Foundation, Older Taxpayers Earn Lion’s Share of Capital Gains Income, available at <http://www.taxfoundation.org/blog/show/26525.html>.

capital gains income, 31 percent were over age 65.⁷ Further, 41 percent of taxpayers reporting capital gains income were between ages 45 and 65, saving for retirement. This age group earned nearly 50 percent of all capital gains income.⁸

In addition to harming older Americans and those saving for retirement, increasing capital gains tax rates would hurt investment. According to CBO⁹ and other studies,¹⁰ increasing capital gains tax rates could create a "lock-in effect" where investors avoid higher taxes by not selling assets. If investors are unwilling to sell taxable assets, the lock-in effect can reduce economic growth by preventing the reallocation of capital to more efficient investments. Further, as the CBO notes, "reductions in capital taxation increase the return on investment and therefore the formation of capital. The resulting increase in the capital stock yields greater output and higher incomes throughout much of the economy."

Finally, lower capital gains taxes have significant economic effects on economic growth, jobs and unemployment, inflation, savings, the financial markets, and debt. A 2010 study by Allen Sinai,¹¹ indicates that the net effect of lower capital gains taxation is a significant plus for U.S. macroeconomic performance. The study found that hiking capital gains tax rates would cause significant damage to the economy, reducing growth in real GDP, raising the unemployment rate, and significantly reducing productivity. The study concluded that these losses outweigh any gains in tax receipts from an increased capital gains rate. Further, the study concluded that higher capital gains taxes would not substantially reduce the deficit.

In sum, raising capital gains rates poses serious risks to the entire economy. Accordingly, the Chamber strongly opposes any increase in these tax rates due to the adverse impact it would have on investment, economic growth, unemployment rates and productivity.

CONCLUSION.

The Chamber thanks the Committee for the opportunity to comment on the taxation of capital gains. The Chamber believes that as the Committee considers fundamental tax reform, the detrimental effects of increased rates must be given the utmost consideration to ensure changes to the tax code allow businesses the opportunity to grow, compete, and innovate. We look forward to working with the Committee and Congress on this vital issue.

⁷ See IRS SOI, available at <http://www.irs.gov/pub/irs-soi/09in15ag.xls>.

⁸ See id.

⁹ See CBO, Capital Gains Taxes and Federal Revenues (October 2002), available at <http://www.cbo.gov/doc.cfm?index=3856&type=0>.

¹⁰ See Heritage Foundation, Web Memo 1891, Economic Effects of Increasing the Tax Rates on Capital Gains and Dividends, available at <http://www.heritage.org/research/reports/2008/04/economic-effects-of-increasing-the-tax-rates-on-capital-gains-and-dividends#ftn2>.

¹¹ See Sinai, Capital Gains Taxes and the Economy, available at http://www.accf_org/publications/139/capital-gains-taxes-and-the-economy.